completely successful, the LEC would have an economic incentive to reallocate these costs back to its general network costs. Because overall costs are recovered through services that are largely intrastate in nature, identification of these costs when the new service is first proposed is needed in order to recognize the state submits for a new video transport service need not be a classic fully-distributed cost study, and the charge factors applied need not simply replicate average factors found on the carrier's books. Nevertheless, it is important to understand how certain cost factors are developed and applied, and three important examples are:

a. ***Depreciation.*** Increasingly in many state tariff filings for new services that LECs' want to promote the carrier's cost support material shows that it is assuming a service life for the assets dedicated to the new service that is *longer than the life assumed for depreciation rate prescription purposes.* This is a subtle but nevertheless potentially very serious source of cross subsidy. If the service life normally assumed for, say, analog circuit electronics is 10-years, but the cost development item for analog circuitry utilized with a new video transport offering equates to 15-years, the LEC must either be able to document why it expects the characteristics of plant used for this particular service to be different from the class as a whole.[7] If this demonstration cannot be provided, then charge factors used to develop costs and ultimately tariff prices must be increased.

b. ***Marketing costs.*** Within the cost support for the LEC's charge factors or other means of calculating the expenses shown for the service, marketing and sales related costs — including "overhead" items such as training personnel to understand and sell the new service offering — must be completely identified, separately from other charge factors and fully documented. As noted above, marketing costs may be part of the start-up costs that must be attributed to the service. Additionally, if active marketing of a new service may not begin until after it is engineered, the

[7]In fact, telephone companies usually seek shorter lives for depreciation rate prescriptions than regulators are willing to award. In these cases, a carrier's assuming a longer than average service life for a new tariff offering in a competitive market would be even more suspect.

cost support material must capture expected future marketing costs and impute their net present value into the tariff ratesetting calculations. These costs are legitimately related to the carrier's economic decision to enter a new services market, and thus are a part of its economic costs. Additionally, and equally important, future marketing costs should be identified when the tariff is submitted in order to provide information that might be useful to state regulators if part of the nominally interstate offering were eventually reallocated to the carrier's state jurisdiction; without this cost information, the state regulatory agency might be powerless to learn how much intrastate ratepayers would be burdened by a less-than-successful interstate service offering.

c. ***Other shared costs.*** In addition, even an appropriate incremental cost study must identify all other sources of shared costs, including maintenance, customer operations and potentially a part of corporate operations as well. In some recent instances, LECs have attempted to depict such costs as not being incremental, that is, to argue that such costs need not be attributed to a new service, because the costs would not be avoided were the service not offered. This argument presupposes that the maintenance, testing and other costs associated with a new video transport tariff either would be devoted to other existing services, or that the personnel and other resources devoted

Because the FCC should not assume either that the new video transport tariff would impair the quality of other services or that the LEC was operating inefficiently, the FCC cannot assume that such shared costs are zero. Accordingly, they must be documented as part of the LEC tariff filing.

7. ***Other reusable and non-reusable costs.*** Finally, it is important that new services cost support material identify whether or not there are other costs associated with the service that are not-reusable. These include customer-specific costs (which cannot be used to service a second customer of the same service) or product specific costs (which are usable only for the video transport offering in question. Likewise, if there are costs other than the ones identified that are more broadly re-usable, and thus might be transferred back to the intrastate jurisdiction, these also should be identified. Only the filing carrier understands the engineering of the new service in question sufficiently to provide this type of information. It cannot be gleaned from any of the other information described above. If there are no such other costs, the carrier's cost support data could simply state "None".

Conclusion

While the description of the cost data and supporting workpapers described above may appear to be complex, in fact all of the information should be a part of the much larger set of information that an LEC would digest before it ever made the decision to offer a new service, such as a new video transport offering. These materials should be available "off-the-shelf" and would provide only the level of detail needed to determine the reasonableness of new services' rate levels.

These specifications do not require that the LEC perform a traditional fully-distributed cost (FDC) analysis, in which broad *categories* of costs are somehow allocated among all of carriers' existing services.[8] One objective of price caps was to eliminate such "top-down" FDC studies.[9]

But the new services cost tests under price caps do require that the full *economic* costs be identified and assigned to the service in question. And, as noted, the full economic costs

[8]The concept of FDC studies thus requires that the firm's total costs be identified and assigned or allocated to services. Treatises generally describe fully distributed costing as "derived from the apportioned total costs of service" Bonbright, Danielsen and Kamerschen, *Principles of Public Utility Rates,* second edition, 1988; [p. 480] or "allocating total revenue requirements among several services or categories of service," Kahn, *The Economics of Regulation*, (1970) [p. 158]. Because the total costs or revenue requirements are not used in price caps regulation, at least for ratesetting purposes, the cost methodology contemplated by the Commission's rules for new services clearly means that a full rendering of the direct costs of a service and its contribution to overheads must, by definition, be determinable from the LEC's cost studies and associated workpapers.

[9]The price cap rules *do* require the associated showing with respect to the overhead costs allocated by the LEC to the service, but this is a separate part of the tariff review process. The reasonableness of such overhead costs cannot be determined unless the direct costs of the service have been accurately identified. If the direct costs, that is the full incremental costs of the service, can be determined to have been properly calculated with respect to the LEC's new service offering, then miscellaneous overhead costs can be calculated -- and reviewed -- separately.

possess both a near-term and longer term component. The cost support plan should be sufficient to identify the stand-alone incremental costs of the service or services in question. The stand-alone costs include all of the costs incurred in order to provide the service, including engineering, marketing and other costs incurred prior to the introduction of the service. All cost components should be identified in an appropriate set of workpapers and a workable framework for video transport cost support.

The Commission has recognized that new LEC services require more detailed cost support than services already contained within the price caps. That determination could be effectively nullified if the cost data and supporting workpapers submitted with an LECs filing were so incomplete as to prevent effective tariff review. The items discussed above, then, are both relatively modest in scope and absolutely essential to apply the price cap rules.

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